

MTD – four practical challenges (Lecture B1095 – 15.20 minutes)

Cash accounting scheme

The new MTD regulations will take effect from 1 April 2019 and will need to be considered by all VAT registered businesses in the UK. There are a number of practical challenges with the regulations, including an important issue with the cash accounting scheme.

Example 1

Jean is a public relations consultant, who is very creative but struggles with record keeping. She uses a simple spreadsheet system, recording all of the income and expenditure into and out of her bank account and she adopts the cash accounting scheme for VAT. She is confused by her accountant's advice that she will need to obtain bridging software to complete her VAT returns after April 2019. She is also concerned by his comment that she will need to process every single purchase and sales invoice - at the moment she only posts payments received and made through her bank account. For example, she uses one subcontractor who raises an invoice for every contract he works on each week but she only pays him once a month (so this means she receives up to 20 purchase invoices each month).

Key question:

With MTD, will it be acceptable for Jean to just post one payment entry a month for her subcontractor or must she process all 20 invoices separately? If the latter, is this not increasing rather than reducing the risk of making errors?

HMRC reply

VAT record keeping requirements are the same whether or not you use the scheme. There are some additional record keeping rules under this scheme. Records must clearly cross-refer payments:

- received to the corresponding sales invoice;
- made to the corresponding purchase invoice;
- made or received to the normal commercial evidence, such as bank statements, cheque stubs or paying-in slips.

MTD does not change any of the above, So, as now, Jean will be required to process all 20 invoices separately otherwise it could create errors. Currently some businesses use figures directly from their bank account and apply the VAT fraction. This is a source of errors as they may assume all purchases are standard rated so if there is anything in the invoices that is not standard rated they will overclaim input tax."

Flat rate scheme (FRS)

Is there an opportunity for reduced MTD record keeping here? Does a user of the FRS need to record purchase invoices digitally if it is not claiming input tax? Scheme users only claim input tax on capital expenditure goods costing more than £2,000 including VAT.

Example 2

Caroline is a hairdresser who uses the FRS. She keeps a record of her daily gross takings in a manual book and at the end of each VAT quarter, she calculates the total takings for the period and applies her flat rate percentage to this figure. With regard to purchase invoices, she staples all of her invoices together for her financial year and gives them to her accountant, who produces her annual accounts.

Key question:

Under the new MTD system, will Caroline need to process all of her purchase invoices in a digital format even though she claims no input tax on her VAT return because she uses the FRS? Will she also need to digitally process her daily takings figures as well?

HMRC reply

HMRC is not making changes to VAT schemes as part of MTD. Businesses such as Caroline's will be eligible to continue using such schemes and MTD requirements will allow for this. Businesses that qualify for MTD using these schemes will be required to comply with MTD digital record keeping requirements and provide VAT returns using functional compatible software.

Under MTD we have replicated the existing relaxations on record keeping for FRS users in the digital record-keeping obligations. Therefore, scheme users within MTD will not need to keep a digital record of:

- purchases (unless they are capital expenditure goods on which input tax can be claimed (Author note – ie costing more than £2,000 including VAT)); or
- the relevant goods used to determine if they need to apply the limited cost business rate.

Spreadsheets

There is still confusion about how a business will comply with the MTD regulations if it adopts spreadsheet accounting and wants to continue to do so.

The HMRC approach is that spreadsheet accounting is fine as long as the business adopts bridging software that links the spreadsheets to the digital VAT return submission. This is a software issue rather than VAT issue but there are hundreds of thousands of businesses which use spreadsheets for their records, often linked with the cash accounting scheme which I considered in the last section. The following are extracts from HMRC Notice 700/22, para 3.2.1:

“Data transfer or exchange within and between software programs, applications or products that make up functional compatible software must be digital where the information continues to form part of the digital records. Once data has been entered into software used to keep and maintain digital records, any further transfer, recapture or modification of that data must be done using digital links. Each piece of software must be digitally linked to other pieces of software to create the digital journey”.

“It follows that transferring data manually within or between different parts of a set of software programs, products or applications that make up functional compatible software is not acceptable under Making Tax Digital.

For example, noting down details from an invoice in one ledger and then using that handwritten information to manually update another part of the business functional compatible software system”.

“A ‘digital link’ is one where a transfer or exchange of data is made, or can be made, electronically between software programs, products or applications. That is without the involvement or need for manual intervention such as the copying over of information by hand or the manual transposition of data between 2 or more pieces of software.”

“A digital link includes linked cells in spreadsheets, for example, if you have a formula in one sheet that mirrors the source’s value in another cell, then the cells are linked.”

“HMRC will allow a period of time (‘the soft landing period’) for businesses to have in place digital links between all parts of their functional compatible software.”

“For the first year of mandation (VAT periods commencing between 1 April 2019 and 31 March 2020) businesses will not be required to have digital links between software programs. The one exception to this is where data is transferred, following preparation of the information required for the VAT Return, to another product (for example, a bridging product) that is API-enabled solely for the purpose of submitting the 9 Box VAT Return data to HMRC. The transfer of data to this product must be digital.”

“For the first year of mandation (VAT periods commencing between 1 April 2019 and 31 March 2020), where a digital link has not been established between software programs, HMRC will accept the use of cut and paste as being a digital link for these VAT periods.”

Deregistration

An easy way to avoid MTD is if your clients are eligible to deregister from VAT before April next year ie taxable sales are expected to be less than £83,000 in the following 12 months. You might think that it will not be a problem anyway if VAT registered clients always trade below the registration threshold of £85,000 and this is correct. But there is always the risk that a business might get a one-off good order and therefore exceed the threshold in one rolling 12-month period after April 2019. Once this has happened, the business is captured by MTD and cannot withdraw if turnover falls below the threshold again. If a business that is not VAT registered has a ‘one off’ period where it exceeds the threshold, then it always has the opportunity to request an exception to being registered ie on the basis that taxable sales in the following 12 months will be less than the deregistration threshold of £83,000.

Reference: HMRC Notice 700/1, para 3.7.

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